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EX PARTE OR LATE FILED

ORIGINAL

October 25, 1996

Mr. William F. Caton, Acting Secretary
Federal Communications Commission
1919 M Street, NW Room 222
Washington, DC 20554

Re: Ex Parte CC Docket 96-45 - Federal-State Joint Board On Universal Service

Dear Mr. Caton:

Please file the enclosed document in the above captioned proceeding. Attached is MCI's analysis of the GTE auction proposal on file with the Commission in this docket.

Two copies of this Notice are being submitted to the Secretary of the FCC in accordance with Section 1.1206(a)(1) of the Commission's rules.

Sincerely,

Kimberly M. Kirby

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Attachment

The GTE Auction Raises Entry Barriers and Limits Competition

The GTE Proposal

- Auctions would be conducted twice annually on specified dates, upon request of a qualified carrier. Qualified bidders submit a notice for areas for which they would like to bid and become the carrier of last resort (COLR).
- For each CBG, a maximum support rate is the difference between the maximum permitted local rate and TELRIC (or potentially a number large than TELRIC).
- The winner(s) receives the sole right to subsidy dollars for a period of three years.
- Auctions are for Census Block Groups (CBG).
- Multiple winners are possible if bids are "close enough" together.[1] The support level equals the second lowest bid. For example, assume that "close enough" equals 10% of the winning bid. If the winning bid was $10 and another bidder bid $11, both firms are designated as COLRs and receive a support payment of $11.
- To reduce explicit or implicit collusion, the auction is a single-round, sealed tender auction.
- If no bids are submitted below the reserve, the ILEC is designated the COLR at the maximum support level equal to TELRIC (or a multiple of TELRIC) minus the local rate. If the ILEC believes the subsidy is

[1] Paul Milgrom (who filed a paper on behalf of GTE) proposes that all bidders within some amount of the lowest bid become COLRs. Three examples are provided. First, all bidders within 15% of the lowest bid become COLRs. Second, if no firm is within 15% of the lowest bid, but a single firm is within 25% of the lowest bid, both become COLRs. Third, if no bid is within 25% of the lowest bid, the lowest bidder becomes the sole COLR. These cases are only illustrative.

too low, it can request an increase in the subsidy at a higher level, subject to state approval. The constraint on the subsidy is the potential for attracting an auction request.

- Once a new COLR is established, the obligations are fixed for three years (subject to performance standards and exogenous adjustments). After three years, any qualified entity could notice the area for an auction. If no notice is issued, then the LEC remains the COLR and the area can be noticed at any time.
- Since a bid may be based on the ability to serve adjacent areas, a bidder may withdraw its bid from one or more areas (subject to a fine) if it loses in adjacent areas.

Problems with the GTE Auction Proposal

- Over the length of the COLR contract, subsidies are not available to carriers that lose the auction or don't bid, reducing both actual and potential competition.
- The auction proposed by GTE is unfriendly to entry into multiple "markets," i.e., the geographic area over which separate bids are made, because it eliminates the entrant's access to cost synergies that would result from sharing facilities across neighboring geographic areas, if the entrant's bid is unsuccessful in one of the areas. GTE recognizes this problem, but does not expect it to be pervasive. As a solution to the problem, GTE proposes that bidders be allowed to withdraw their bid (with penalty) if the failure to win COLR status in one or more areas interferes with the entrant's global entry strategy. This proposed remedy ignores the fact that bids will likely be based on an entry strategy covering more than a single arbitrarily chosen geographic area (due to cost synergies) and that the failure to win in a single area could lead to a withdrawal of bids from all areas for which the entrant considered providing services. Additionally, if COLR status has been granted for geographic areas that are part of a potential entrant's global entry strategy, the entrant may choose not to enter at all if it is excluded from the effective demand in these areas where a COLR been assigned prior to the finalization of the entrant's global entry strategy.

- Forcing a potential entrant to participate in an auction for each market it wants to enter or may want to enter at some time in the near future increases the entrant's cost and thus raises barriers to entry (since the incumbent firm has no entry decision to make). Since the auctions may occur before some potential entrants have finalized their entry strategy, some firms will certainly be blocked-out of the process. The auction also notifies the incumbent of entry and offers it the opportunity to signal to the entrant with a low bid to stay out of its market, thereby deterring entry.
- Since the subsidy is TELRIC minus price, overstating TELRIC will lead to a larger subsidy. GTE's approach encourages an overgenerous estimation of TELRIC by purportedly reducing the "risk" of overstating TELRIC. It can be claimed that the auction encourages firms to bid-away any excess subsidy. While the GTE auction <u>may</u> prevent high subsidies at the risk of limiting the full benefits of new entry, it does nothing to correct for too high unbundled element prices arising from inflated TELRIC estimates. Indeed, one might argue that the entire proposal is intended to undermine the TELRIC estimates so that ILECs can manipulate the entry conditions to favor themselves.
- It is also unclear what effect the GTE auction will have on the rates for unbundled elements. If TELRIC is "too low" for universal service purposes, is it also "too low" for unbundled elements pricing? Or, inversely, will an ILECs bidding down of subsidy requirements be matched in terms of lowering rates of unbundled elements?
- As in any regulatory regime that prohibits competitive entry, regulators must monitor the performance of the COLR to ensure a specified level of performance. If the COLR fails to maintain the quality of service as stipulated in the COLR contract, what recourse do regulators have if others firms do not have access to the subsidy? Furthermore, if a COLR were to lose its right to subsidy dollars by failing to meet performance standards, will its customers be forced to switch to the new COLR despite their wishes? If all firms have access to the subsidy, however, the need to monitor performance is substantially reduced.